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SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. 78-293

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al. - - - - - **Appellants**

versus

WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville - - - - - - - - - **Appellees**

On Appeal From the Court of Appeals of Kentucky

MOTION OF APPELLEES TO DISMISS APPEAL

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v.

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ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

MOTION OF APPELLEES TO DISMISS APPEAL

In accordance with Rule 16(1)(b) of the Rules of the Court, the Appellees hereby move the Court to dismiss this appeal on the ground that this appeal manifestly does not present a substantial Federal question warranting argument or further consideration.

COUNTERSTATEMENT OF QUESTION PRESENTED

May state and local governments under 31 U.S.C. §742 (R.S. §3701) and the prior decisions of this Court deny corporations a deduction for interest earned on Federal bonds and obligations in computing their liability for a privilege or franchise tax measured by net income?

COUNTERSTATEMENT OF CASE

The City of Louisville and Jefferson County, in which Louisville is located, both levy a general occupational license tax. Additionally, a third general occupational license tax is levied by the County for the benefit of local schools. The Appellees, as the individual members of the Commissioners of the Sinking Fund of the City of Louisville, a public corporate body existing under §91.130 of the Kentucky Revised Statutes ("KRS"), collect all three of these taxes. Inasmuch as the County and school taxes closely resemble the City tax, upon which they were modelled, the Appellees will, as the Appellants have done, limit their discussion to the City tax.

The City tax is authorized by KRS 91.200 and §181 of the Kentucky Constitution and is levied pursuant to ordinances consolidated in Chapter 727 of the Codified General Ordinances of Louisville. As more fully discussed hereafter, the tax is measured by a small flat percentage of the gross compensation of salaried workers and wage earners and of the net income of businesses and self-employed persons.

The Appellants are all savings and loan associations, which have always claimed to be wholly exempt from the general occupational license taxes. In 1974 suit was brought to test this claim. Early in the proceedings, 31 U.S.C. §742 and the case law related thereto came to the attention of the Appellees and they indicated their intent, in the event the Appellants were not found wholly exempt from license taxes, to deny them,

and all other corporations thereafter, a deduction for interest on Federal bonds and obligations in computing their license tax liability. The issue was thereupon joined between the Appellants and Appellees. (Previously, the Appellees had mistakenly believed that Federal law mandated a deduction for interest on Federal obligations and so had allowed all taxpayers such a deduction although no provision of the Louisville ordinances or Kentucky statutes authorized one.)

The courts below found the Appellants to be subject to the general occupational license taxes. Additionally, it was decided that the Appellees could deny the Appellants a deduction for interest on Federal bonds and obligations in computing their license tax liability under the provisions of 31 U.S.C. §742 and the decisions of this Court relative to the subject.

FEDERAL QUESTION NOT SUBSTANTIAL

The crux of this case is obviously the nature and incidence of the occupational license taxes. In this regard, §727.02(a) of the Louisville Ordinances, under which the City tax is imposed, provides as follows:

> "On and after January 1, 1959, every person, association, corporation or other entity engaged in any occupation, business, trade, profession or other activity in the City shall pay into the Sinking Fund an annual license fee for the privilege of engaging in said activities, which license fee shall be measured by one and one-fourth (1¼%) percent of (a) all salaries, wages, commissions and other compensation earned by every person in the City for work done or services performed or ren-

dered in the City; and (b) the net profits of all businesses, professions or occupations from activities conducted in the City."

A person's net profit for purpose of the City license tax is defined by §727.01(j) of the Ordinances to be essentially his net income for Federal income tax purposes (see Appendix B to Jurisdictional Statement).

From the foregoing, it is manifest that the Louisville general occupational license tax is a privilege tax measured by either gross compensation or net income depending upon the taxpayer. With regard to corporate taxpayers, to which this appeal relates exclusively, the City tax is imposed for the privilege of transacting business and the exercising of their corporate franchises in Louisville.

The nature of the City occupational license tax has been previously considered by this Court in *Howard* v. *Commissioners of the Sinking Fund of the City of Louisville,* 344 U. S. 624 (1953), a case concerning whether the imposition of the City tax on Federal employees was authorized by the Buck Act (4 U.S.C. §105 et seq.). A majority of the Court held that while the City tax was categorized as a privilege tax, it came within the special definition of an income tax for purposes of the Buck Act. Under 4 U.S.C. §110(c) an "income tax" for purposes of the Act is defined as "any tax levied on, with respect to, or measured by, net income, gross income or gross receipts." Accordingly, the Court found that the Buck Act authorized Louisville to collect occupational license taxes from Federal employees working in the City. Two members of the

Court, however, Justice Douglas and Justice Black, dissented. In their opinion, the City tax was, as the Kentucky courts had found, a privilege tax and was too dissimilar from an income tax to qualify even under the broad definition of the Buck Act.

The general exemption of Federal bonds and obligations, and the interest thereon, from state and local taxation is set forth in 31 U.S.C. §742 (R.S. §3701) (Appendix C to Jurisdictional Statement). In 1959, Congress amended §742 so as to include two exceptions to the rule of general immunity. Under one of these exceptions, state and local governments are now expressly authorized to levy with regard to Federal bonds and obligations, and the interest thereon, "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations." The Appellees submit that as the two courts below found, this exception encompasses and permits the imposition of the City occupational license tax on the full net income of Appellants, including their income from Federal obligations.

To consider the specific elements of the exception, the City occupational license tax is nondiscriminatory within the criteria established by this Court in *Tradesmens Nat. Bank* v. *Oklahoma Tax Comm.,* 309 U. S. 560 (1940), in that the tax is imposed upon the entire net income of taxpayers without regard to its source and there is no distinction between income from Federal bonds and obligations and income otherwise derived. The interest from Federal obligations is included in income for City license tax purposes not by any

special provision of the Louisville ordinances but only by their general language.

The Appellants are all Federal savings and loan associations chartered under the Home Owners' Loan Act of 1933 (12 U.S.C. §1461 et seq.) and do not deny that they are corporations. Accordingly, this case devolves into a consideration of whether the City and other two occupational license taxes at issue here may be categorized as "franchise or other nonproperty taxes in lieu thereof."

The Appellants argue strenuously that because the occupational license taxes are measured by income, they are *ipso facto* income taxes and therefore not within the ambit of 31 U.S.C. §742. A long line of decisions of this Court, however, stretching back into the 19th century has rejected this simplistic proposition. In these cases, the Court has upheld franchise and privilege taxes measured either by assets or income imposed on corporations and requiring the inclusion of Federal bonds and obligations, or the interest from same, in the computation of the amount of tax due. The 1959 amendment to 31 U.S.C. §742 to include an exception for these taxes did no more than give statutory recognition to the rule long established by this Court. The Appellees submit that the amendment must have been intended to cover taxes measured by assets or income since there is no need for such an exception with regard to franchise taxes imposed at a flat rate or otherwise measured.

As far back as 1868, this Court in *Society for Savings* v. *Coite,* 73 U. S. (6 Wall.) 594, and *Provident*

Institution for Savings v. *Massachusetts,* 73 U. S. (6 Wall.) 611, sustained the validity of state franchise or privilege taxes imposed on mutual savings institutions much like the Appellants herein and measured by a percentage of their deposits, or gross assets, including the portion invested in Federal bonds and obligations. See also *Home Ins. Co.* v. *New York,* 134 U. S. 594 (1890).

In *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 71 A.L.R. 1226 (1931), the Court upheld the validity, against essentially the same challenge raised by the Appellants here, of a New York franchise tax measured by net income. While noting the Court's many decisions prohibiting the direct taxation by state and local governments, on the one hand, and the Federal government on the other, of each other's obligations, Justice Stone for the majority continued:

> [This Court] has held with like consistency that the privilege of exercising the corporate franchise is no less an appropriate object of taxation by one government merely because the corporate property or net income, which is made the measure of the tax, may chance to include the obligations of the other, or the income derived from them. The constitutional power of one government to reach this permissible object of taxation may not be curtailed because of the indirect effect which the tax may have upon the other. 282 U. S. at 389.

In reaching the decision above, the Court relied in part on *Flint* v. *Stone Tracy Co.,* 220 U. S. 107 (1911), in which the Court, confronted with the reverse situation, upheld the validity of a Federal franchise tax on

corporations measured by net income, including interest on state and local bonds and obligations not directly subject to Federal tax.

In both *Educational Films Corp.* and *Flint, supra,* the Court recognized that a franchise or privilege tax measured by income differs from an income tax in that to be liable for a tax of the former type, one must actually transact business and when business ceases, so does liability for the tax. The Louisville license tax is a franchise tax in this regard in that to be liable one must expressly be "engaged in . . . business . . . or other activity in the City" and when such activity stops, so does the tax.

By 1940, the Court could state in *Tradesmens Nat. Bank* v. *Oklahoma Tax Comm.,* 309 U. S. 560, 564-65, that:

> "The power of a state to levy a tax on a legitimate subject, such as a franchise, measured by net assets or net income including tax-exempt federal instrumentalities or their income is . . . well settled. *Society for Savings* v. *Coite* . . . *Provident Inst.* v. *Massachusetts* . . . *Home Ins. Co.* v. *New York* . . . *Educational Films Corp.* v. *Ward.* . . . The rule that a tax upon a legitimate subject, measured by net income, including that from tax-immune federal instrumentalities, is not an infringement of the immunity, was affirmed in *Flint* v. *Stone Tracy Co.* . . . and followed in *Educational Films Corp.* v. *Ward.*..."

Other decisions of the Court reiterating the same principles relative to this appeal as the cases cited above include *Werner Machine Co.* v. *Director of Div.*

of Taxation, 350 U. S. 492 (1956), and *Pacific Co.* v. *Johnson,* 285 U. S. 480 (1932).

As a tax levied on corporations for the privilege of engaging in business and exercising their corporate franchise in Louisville, the City license tax, and the other two occupational license taxes at issue here, come precisely under the exception to the general rule of state and local tax immunity of federal obligations long ago established by this Court and now contained in 31 U.S.C. §742. No Federal question not already well settled is presented by this appeal and there is no need for the Court to hear argument or consider this case further.

The same issues presented by this appeal were before the court as recently as 1975 in the appeal taken to this Court from the decision in *Reuben L. Anderson-Cherne, Inc.* v. *Comm'r of Taxation,* 303 Minn. 124, 226 N. W. 2d 611 (1975). Relying on 31 U.S.C. §742 and the decisions of this Court, the Minnesota Supreme Court in that case upheld a Minnesota corporate franchise tax measured by net income, including interest from Federal bonds and obligations. This Court dismissed the appeal for want of a substantial Federal question. 423 U. S. 886. The Appellees submit that the same action should now be taken with respect to this appeal and have so moved the Court.

Respectfully submitted,

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